

Message Text

PAGE 01 NATO 00412 01 OF 03 251940Z

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ACTION EUR-25

INFO OCT-01 ISO-00 DODE-00 EB-11 SS-20 NSC-10 FEA-02 SCI-06

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RSC-01 PRS-01 SPC-03 TRSE-00 SAJ-01 USIE-00 SSO-00

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S E C R E T SECTION 1 OF 3 USNATO 412

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TAGS: ENRG, NATO, PFOR

SUBJECT: ENERGY: ECONOMIC COMMITTEE REPORT ON WORLD OIL CRISIS
AND THE ALLIANCE

STATE ALSO FOR T/IEP

REF: A) USNATO 0276; B) STATE 010343; C) USNATO 0354;

D) STATE 015378

SUMMARY: THIS MESSAGE REVIEWS CHANGES IN ECONAD DRAFT
REPORT TO COUNCIL ON WORLD OIL CRISIS AND THE ALLIANCE.
MISSION BELIEVES REPORT CONSTITUTES STRONG ARGUMENT
FOR ALLIED COLLABORATION ON ENERGY. WE RECOMMEND EARLY
US APPROVAL IN ECONOMIC COMMITTEE TO PERMIT COUNCIL
DISCUSSION PRIOR TO WASHINGTON ENERGY CONFERENCE.
END SUMMARY.

1. MISSION TODAY POUCHED TO EUR/RPE/TARRANT FULL TEXT
OF REVISED ECONAD DRAFT REPORT TO COUNCIL ON WORLD
OIL CRISIS AND THE ALLIANCE AC/127-WP/373 (REVISED).

SECRET

PAGE 02 NATO 00412 01 OF 03 251940Z

HOWEVER, DISCUSSION AT ECONOMIC COMMITTEE JANUARY 24
RESULTED IN FURTHER PROPOSED CHANGES IN DRAFT.

2. REVISED

/VERSION, UNLIKE PREVIOUS DRAFT, CONTAINS SUMMARY AND CONCLUSIONS, HOWEVER, THE SUMMARY AND CONCLUSIONS WE TRANSMITTED BY REFTEL C, WHICH APPEAR AS OPENING SECTION OF AC/127-WP/373 (REVISED), WERE MODIFIED AT JANUARY 24 MEETING. PARAS 1-12 OF SUMMARY AND CONCLUSIONS IN REFTEL A ARE VIRTUALLY UNCHANGED. JANUARY 24 VERSION OF REMAINDER OF SECTION (PARAS 13-19) FOLLOW AT END OF THIS CABLE.

3. MAIN CHANGE IN REVISED VERSION FROM US VIEWPOINT IS DELETION OF SPECIFIC REFERENCE TO WASHINGTON ENERGY CONFERENCE AND TO EC EFFORTS AT RESOLVING CRISIS, BOTH IN SUMMARY AND CONCLUSIONS, AND IN PART IV "MOVES TO OVERCOME THE OIL CRISIS" (WHICH DID NOT EXIST IN PREVIOUS DRAFT). FRENCH REP STATED AT JANUARY 24 MEETING THAT FAIRNESS REQUIRED MENTION OF ALL EFFORTS AT RESOLVING CRISIS, E.G., FRENCH PROPOSALS FOR EUROPEAN-ARAB CONFERENCE, UN ENERGY CONFERENCE, AS WELL AS BILATERAL ARRANGEMENTS. SEVERAL COUNTRIES AGREED THAT THE REPORT SHOULD COVER ALL MOVES TO OVERCOME CRISIS IF IT COVERED ANY. HOWEVER, CHAIRMAN OBSERVED THAT OBTAINING ECONAD AGREEMENT ON SUCH A REVISION WOULD UNNECESSARILY DELAY TRANSMISSION OF DOCUMENT TO COUNCIL. HE SUGGESTED DELETION OF REFERENCE TO US AND EC EFFORTS FROM SUMMARY AND CONCLUSIONS, AS WELL AS DELETION OF ENTIRE PART IV. HE WOULD REVIEW THE VARIOUS EFFORTS IN HIS COVER NOTE TO THE COUNCIL. MOST ECONADS (INCLUDING FRENCH) FAVORABLE TO THIS PROCEDURE.

4. THE OTHER PRINCIPAL CHANGES OF INTEREST FROM U.S. VIEWPOINT ALSO FOLLOW AT END OF CABLE: PARAS 22 AND 23, WHICH REPLACE PARAS 2 AND 3 OF OLD VERSION: PARAS 61-63 WHICH CONSTITUTE NEW SECTION ON OIL PRODUCER PURCHASE OF GOODS, SERVICES, AND ARMAMENTS; PARAS 66-72, WHICH ARE EXPANSION OF OLD PARAS 90-92 ON USSR ROLE IN THE CRISIS. OTHER CHANGES CONSIST MAINLY IN UPDATING AND REORGANIZATION.

SECRET

PAGE 03 NATO 00412 01 OF 03 251940Z

5. COMMITTEE CHAIRMAN URGED FINAL ECONAD APPROVAL OF OIL REPORT BY JANUARY 31, IN ORDER THAT COUNCIL MAY CONSIDER IT AT AN EARLY DATE. FRENCH REP SAID HE DID NOT SEE NEED FOR URGENCY.

6. COMMENT: PRESENT VERSION
/OF OIL REPORT CONSTITUTES STRONG ARGUMENT FOR ALLIED COLLABORATION ON ENERGY AND IS CONSISTENT WITH US ENERGY INITIATIVE. THIS VERSION NO LONGER SPECIFICALLY REFERS TO U.S. INITIATIVE, BUT WE BELIEVE THIS IS PREFERABLE TO LUMPING US PROPOSAL, FRENCH PROPOSALS AND BILATERAL DEALS IN SAME SECTION UNDER HEADING "MOVES TO OVERCOME THE OIL CRISIS". MISSION BELIEVES NAC DISCUSSION

OF THIS REPORT PRIOR TO WASHINGTON ENERGY CONFERENCE
IS IN US INTEREST. US MUST APPROVE DOCUMENT IN ECONOMIC
COMMITTEE BY JANUARY 31 FOR THIS TO BE POSSIBLE. DEPART-
MENT NOW HAS FULL TEXT OF DRAFT SUMMARY AND CONCLUSIONS,
WHICH WILL SERVE AS PRINCIPAL FOCUS OF NAC DISCUSSION, AS
WELL AS MAIN CHANGES IN PREVIOUS VERSION OF WHOLE DOCUMENT,
WHICH DEPARTMENT CONSIDERED "EXCELLENT". IF DEPARTMENT AWAITS
POUCHED COPIES OF ENTIRE REVISED DRAFT, OR RECOMMENDS
EXTENSIVE CHANGES, WE SHALL MISS THE OPPORTUNITY FOR
COUNCIL DISCUSSION PRIOR TO WASHINGTON CONFERENCE.

BEGIN TEXTS -

13. THE OPEC COUNTRIES' ABILITY TO ABSORB FUNDS IS NOT
UNLIMITED. ACCOUNT
SECRET

PAGE 01 NATO 00412 02 OF 03 251929Z

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ACTION EUR-25

INFO OCT-01 ISO-00 DODE-00 EB-11 SS-20 NSC-10 FEA-02 SCI-06

INT-08 CIAE-00 PM-07 INR-10 L-03 NEA-11 NSAE-00 PA-04

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FM USMISSION NATO
TO SECSTATE WASHDC IMMEDIATE 3737
INFO USMISSION EC BRUSSELS

S E C R E T SECTION 2 OF 3 USNATO 0412

(1) SCHEMES ARE CURRENTLY BEING MOOTED IN CERTAIN CIRCLES FOR
THE CHANNELLING THROUGH INTERNATIONAL ORGANIZATIONS OF
SOME OF THESE FUNDS WITH A VIEW TO INCREASING AID TO THE
DEVELOPING COUNTRIES. THIS COULD BE ONE OF THE ELEMENTS
OF A SOLUTION

(2) IN 1973, THE GNP OF FRANCE WAS ESTIMATED AT \$218 MILLIARDS
AND THAT OF THE UNITED KINGDOM AT \$150 MILLIARDS. WORLD
RESERVES AT THE END OF 1973 TOTALLED APPROXIMATELY
\$200 MILLIARDS

14. OVER AND ABOVE DELIVERIES OF INDUSTRIAL PLANT, ARMS
SALES TO THE MIDDLE EAST AND GULF COUNTRIES REPRESENT A
BARGAINING COUNTER FOR THE OIL NEEDED BY THE INDUSTRIALIZED

WORLD. THE MILITARY EQUIPMENT IN QUESTION IS EXTREMELY COSTLY AND SOPHISTICATED; ALSO, BEING DICTATED BY POLITICAL CONSIDERATIONS, THE DEMAND FOR ARMS IS HIGHLY FLEXIBLE. HOWEVER, IN THE MEDIUM AND LONG-TERM, THESE DELIVERIES COULD LEAD TO AN EXPLOSIVE SITUATION IN THIS AREA, WHERE THERE IS NO SHORTAGE OF EITHER LATENT OR LIVE CONFLICTS. THIS INVOLVES A SECRET

PAGE 02 NATO 00412 02 OF 03 251929Z

CONSIDERABLE THREAT TO THE ALLIANCE, WHOSE OIL SUPPLIES FROM THIS PART OF THE WORLD COULD BE SEVERELY CURTAILED IN THE EVENT OF A CONFLICT.

15. THE SOVIET UNION IS A NET EXPORTER OF OIL, TO THE WEST AS TO OTHER COUNTRIES. IN THE FORESEEABLE FUTURE THE OUTLOOK FOR SOVIET OIL PRODUCTION IS PROMISING, PARTICULARLY IF CO-OPERATIVE AGREEMENTS ARE CONCLUDED WITH THE WEST. BY AND LARGE THE USSR HAS REMAINED ALOOF FROM THE PRESENT OIL CRISIS, THE CONSEQUENCES OF WHICH IT APPARENTLY HAD NOT ANTICIPATED, ALTHOUGH ITS PROPAGANDA MEDIA HAD ON SEVERAL OCCASIONS ENCOURAGED THE ARAB COUNTRIES TO USE THEIR OIL AS A POLITICAL COUNTER IN THEIR DEALINGS WITH THE REST OF THE WORLD. HOWEVER, A DISTINCTION SHOULD BE MADE IN THIS CONNECTION BETWEEN THE USSR AND THE EAST EUROPEAN COUNTRIES, WHICH LIKE WESTERN EUROPE, ARE HEAVILY DEPENDENT ON IMPORTS OF HYDROCARBONS.

16 THE PRESENT CRISIS COULD HAVE ADVERSE EFFECTS ON ALLIANCE SOLIDARITY. FOR INSTANCE, THE PRESENT SITUATION COULD GIVE RISE TO DIVERGING INTERESTS IN THE ECONOMIC AND MONETARY FIELDS BETWEEN ALLIED COUNTRIES EITHER AS A RESULT OF CHAIN REACTION DEVALUATIONS OR A RETURN TO PROTECTIONISM OR AGAIN TO A TIGHTENING OF EXCHANGE CONTROLS. ANY SUCH SITUATION WOULD RUN COUNTER TO ARTICLE 2 OF THE NORTH ATLANTIC TREATY. IT COULD THUS JEOPARDIZE THE VITAL INTERESTS OF THE ALLIANCE AS A WHOLE OR CERTAIN OF ITS MEMBERS, AND ESPECIALLY THOSE WHOSE ECONOMIC DEVELOPMENT IS MOST SLUGGISH.

17. FINALLY, IT IS PROBABLE THAT, BY AGGRAVATING FINANCIAL, SOCIAL AND ECONOMIC PROBLEMS, THESE UPHEAVALS WILL LEAD TO PRESSURES IN THE ALLIED COUNTRIES TO USE FOR OTHER PURPOSES RESOURCES CURRENTLY AVAILABLE FOR DEFENCE.

18. IN THE LIGHT OF THE FOREGOING, IT IS ESSENTIAL THAT PRODUCER AND CONSUMER COUNTRIES ENTER INTO MUTUAL COMMITMENTS AIMED AT ACHIEVING A FAR HIGHER DEGREE OF CO-OPERATION. THE CONSUMERS RECOGNIZE THE RIGHT OF THE PRODUCERS TO MAINTAIN THEIR PURCHASING POWER SO AS TO SAFEGUARD THEIR CHANCES OF FUTURE ECONOMIC DEVELOPMENT, AND THE PRODUCERS MUST RECOGNIZE THE RIGHT OF THE CONSUMERS TO RELIABLE AND REGULAR OIL SUPPLIES. THIS QUESTION IS OF PARAMOUNT IMPORTANCE FOR THE DEVELOPING SECRET

PAGE 03 NATO 00412 02 OF 03 251929Z

COUNTRIES, WHICH ARE HARD HIT BY THE RECENT RISES IN PRICE.
INDEED, THE EXTRA AMOUNT THEY ARE HAVING TO PAY IS EQUAL TO THE
ASSISTANCE THEY RECEIVE FROM THE WESTERN COUNTRIES.

19. IN VIEW OF THE THREAT WHICH THE PRESENT ENERGY
CRISIS PRESENTS IN THE POLITICAL AND ECONOMIC SPHERES, THE
WIDEST POSSIBLE MEASURE OF SOLIDARITY BETWEEN ALLIED
COUNTRIES IS NECESSARY.

PART I - MEASURES ALREADY TAKEN OR LIKELY TO BE TAKEN BY THE
PETROLEUM-PRODUCING COUNTRIES

A. BREAK-UP OF THE LEGAL FRAMEWORK

22. TO ALL INTENTS AND PURPOSES, THE BREAK-UP OF THE
TRADITIONAL LEGAL AND INSTITUTIONAL FRAMEWORK FOR WORLD OIL
TRANSACTIONS STARTED WITH THE CREATION OF THE ORGANIZATION OF
PETROLEUM EXPORTING COUNTRIES (OPEC) IN SEPTEMBER 1960, ON THE
INITIATIVE OF VENEZUELA. THE PURPOSE OF THIS MOVE WAS TO HALT
THE DOWNWARD TREND IN CRUDE OIL PRICES, ON THE BASIS OF WHICH
THE REVENUE OF THE PRODUCING COUNTRIES IS CALCULATED. FOR
MANY REASONS, INCLUDING THE DIVERGING ECONOMIC INTERESTS OF THE
MEMBER COUNTRIES (1), THIS CARTEL OF PRODUCING COUNTRIES REMAINED
VIRTUALLY INEFFECTIVE UNTIL THE END OF THE 1960S. HOWEVER, IN
THE ENSUING YEARS, THE PICTURE WAS ENTIRELY CHANGED: THE
DISAPPEARANCE OF OIL SURPLUSES TRANSFORMED THE BUYERS' MARKET
SECRET

PAGE 01 NATO 00412 03 OF 03 252025Z

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ACTION EUR-25

INFO OCT-01 ISO-00 DODE-00 EB-11 SS-20 NSC-10 FEA-02 SCI-06

INT-08 CIAE-00 PM-07 INR-10 L-03 NEA-11 NSAE-00 PA-04

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INFO USMISSION EC BRUSSELS

S E C R E T SECTION 3 OF 3 USNATO 0412

23. ACCORDING TO FORECASTS PREPARED BEFORE THE PRESENT
CRISIS, THE DEMAND FOR OIL IN THE THREE MAJOR INDUSTRIAL REGIONS
OF THE NON-COMMUNIST WORLD (NORTH AMERICA, WESTERN EUROPE AND

JAPAN) WAS EXPECTED TO GROW DURING THE PRESENT DECADE AT A FASTER ANNUAL AVERAGE RATE (6 PER CENT) THAN GDP (4.75 PER CENT). THIS FORECAST TOOK ACCOUNT OF OTHER FACTORS WHICH HAVE ALTERED THE SITUATION THAT PREVAILED IN THE 1960S: CONCERN ABOUT THE QUALITY OF THE ENVIRONMENT, A SHARP RISE IN THE UNITED STATES DEMAND FOR HYDROCARBON IMPORTS, THE PREPONDERANT ROLE OF OIL IN THE ECONOMIES OF WESTERN EUROPE AND JAPAN, THE MEASURES TAKEN BY CERTAIN PRODUCING COUNTRIES TO HUSBAND THEIR OIL RESERVES AND THE GRADUAL DECLINE OF WESTERN INFLUENCE IN THE MIDDLE EAST. THE COMBINED EFFECT OF ALL THESE FACTORS HAS SWUNG THE SITUATION COMPLETELY IN OPEC'S FAVOUR VIS-A-VIS THE CARTEL OF MAJOR OIL COMPANIES. THIS PROCESS WAS SWIFT AND BRUTAL. IN SO FAR AS THE ARAB PETROLEUM-EXPORTING COUNTRIES WERE CONCERNED, THE TREND TOWARDS A NEW RELATIONSHIP WITH THE CONCESSION-HOLDING COMPANIES WAS HASTENED BY THE RECENT CONFLICT WITH ISRAEL, AS OIL CAME TO PLAY A PART IN THESE COUNTRIES' POLICY TOWARDS "OUTSIDE" NATIONS. THE DEVELOPMENTS OF RECENT MONTHS HAVE MARKED A RADICAL CHANGE IN THE SYSTEM WHEREBY RELATIONS BETWEEN PRODUCING
SECRET

PAGE 02 NATO 00412 03 OF 03 252025Z

AND CONSUMER COUNTRIES WERE CHANNELLED THROUGH THE OIL COMPANIES.

61. AS REGARDS ADDITIONAL PURCHASES BY THE OPEC COUNTRIES OF GOODS AND SERVICES FROM THE WEST, IT HAS BEEN ESTIMATED THAT, AT BEST, THESE COUNTRIES WILL BE ABLE TO BOOST IMPORTS BY SOME \$10 MILLIARD IN 1974 BRINGING THE TOTAL COST OF THEIR PURCHASES UP TO ABOUT \$30 MILLIARD. IT SHOULD BE NOTED IN THIS CONNECTION THAT THE PERSIAN GULF COUNTRIES TO WHICH SOME 60 PER CENT OF OIL REVENUE WILL ACCRUE, WILL PROBABLY BE UNABLE TO STEP UP THEIR IMPORTS TO THIS EXTENT.

62. ARMAMENTS RANK HIGH ON THE SHOPPING LIST. FOR THE INDUSTRIALIZED COUNTRIES, THESE SALES HAVE A HIGH TECHNICAL, COST AND PRICE CO-EFFICIENT WHICH ENABLES THEM TO COMPENSATE ON FAVOURABLE TERMS FOR THEIR PURCHASES OF ENERGY. AS FOR THE OIL PRODUCING COUNTRIES, THESE PURCHASES ARE MADE FOR STRATEGIC OR PRESTIGE REASONS WHICH ARE LITTLE AFFECTED BY CONSIDERATIONS OF COST. FROM THE VIEWPOINT OF BOTH SUPPLY AND DEMAND, ARMAMENTS TRANSACTIONS ARE EXTREMELY ELASTIC. IT WOULD BE UNWISE HOWEVER TO DISREGARD THE FACT THAT MILITARY TRANSACTIONS ARE OF A SPECIAL KIND WHICH, WHILE HAVING OBVIOUS ECONOMIC ADVANTAGES, ALSO CARRY WITH THEM AN ELEMENT OF POLITICAL AND MILITARY RISK WHICH MUST NOT BE UNDERESTIMATED. THE SUPPLY OF EQUIPMENT TO STATES WITH FRAIL POLITICAL STRUCTURES AND WHICH ALSO HAVE TO CONTENT WITH PERSISTENT LATENT CONFLICTS, INCREASES THE RISK OF CLASHES IN THE PERSIAN GULF AREA. THE OUTBREAK OF A MAJOR CONFLICT WOULD INEVITABLY LEAD TO THE MOMENTARY OR PERMANENT SUSPENSION OF OIL SUPPLIES, TO THE DETRIMENT OF CONSUMER COUNTRIES.

63. LASTLY, IT MUST BE REMEMBERED THAT CERTAIN ARAB COUNTRIES WHICH DO NOT PRODUCE OIL ARE IN RECEIPT OF LARGE

CURRENCY SUBSIDIES FROM THE OPEC ARAB COUNTRIES WHICH THEY USE TO FINANCE THE PROCUREMENT OF MILITARY EQUIPMENT AND OTHER ITEMS IN THE USSR. THE LATTER COULD FOR ITS PART USE THESE CURRENCIES FOR PURCHASES IN THE WEST.

PART III - THE SOVIET UNION'S ROLE IN THE CRISIS

66. SOVIET PROPAGANDA HAS OFTEN ENCOURAGED THE ARAB COUNTRIES TO USE OIL AS A POLITICAL LEVER AGAINST THE WEST.

SECRET

PAGE 03 NATO 00412 03 OF 03 252025Z

HOWEVER, SINCE THE CRISIS BROKE, MOSCOW SEEMS TO HAVE TRIED TO AVOID GETTING INVOLVED ON ONE SIDE OR THE OTHER AND IS CONTENTING ITSELF WITH SUPPLYING ITS WESTERN CUSTOMERS UNDER THE CONTRACTS CONCLUDED WELL BEFORE 6TH OCTOBER, 1973. IT IS WORTH NOTING THAT OIL DELIVERIES TO FRANCE AND THE FRG IN 1973 HAVE SO FAR FALLEN WELL SHORT OF THE AMOUNTS CONTRACTED FOR. HOWEVER, THERE IS NO WAY OF TELLING WHETHER THIS CUT-BACK ON SALES IS THE RESULT OF PRODUCTION OR TRANSPORT DIFFICULTIES OR WHETHER IT IS DELIBERATE POLICY AND CONNECTED WITH THE MIDDLE EAST CONFLICT.

67. MOSCOW SEEMS TO BE STRIVING BOTH TO SAFEGUARD DETENTE WITH THE COUNTRIES OF THE ALLIANCE AND TO MAINTAIN GOOD RELATIONS WITH THE ARAB STATES. FOR MANY YEARS NOW, THE SOVIET UNION HAS SHOWN AN ACTIVE INTEREST IN THE OIL INDUSTRY IN SEVERAL OF THESE COUNTRIES. IN EGYPT, THIS TOOK THE FORM, UNTIL JULY 1973, OF A WIDE RANGE OF LARGELY UNSUCCESSFUL PROSPECTING OPERATIONS CARRIED OUT ON BEHALF OF THE STATE. ALGERIA HAS BEEN PROVIDED WITH SUBSTANTIAL TECHNICAL AND MATERIAL ASSISTANCE, WHICH UNDOUBTEDLY HASTENED THE NATIONALISATION OF THE ALGERIAN OIL INDUSTRY BY SONATRACH. IN IRAQ, THE SOVIET UNION AND SEVERAL OTHER EASTERN COUNTRIES MADE A BIG FINANCIAL AND TECHNICAL CONTRIBUTION TO THE DEVELOPMENT OF THE NORTH RUMAILA OIL FIELDS. THEY ALSO PROVIDED IRAQ WITH SOME ASSISTANCE WHEN IT NATIONALIZED THE IPC IN JUNE 1972.

68. IN ANY EVENT, IT WOULD APPEAR IMPOSSIBLE FOR THE SOVIET UNION TO ABSORB THE OIL NO LONGER SOLD TO THE WEST. THE AMOUNT IS VERY LARGE: 150 MILLION TONS A YEAR ON THE BASIS OF THE PERCENTAGE EMBARGOED IN JANUARY 1974, OR RATHER MORE THAN A THIRD OF THE FORECAST SOVIET OUTPUT FOR 1974.

69. MOREOVER, IF THE SOVIET UNION SHOULD TAKE TO BUYING OIL IN LARGE QUANTITIES, IT WOULD ONLY DO SO WITH A VIEW TO RE-EXPORTING IT TO THE REST OF THE WORLD. THE EFFECT OF THIS WOULD BE TO REDUCE THE BITE OF THE OIL SQUEEZE, SINCE SUPPLIES WOULD BE REACHING THE WESTERN COUNTRIES ON WHICH THE ARAB COUNTRIES ARE SEEKING TO EXERT PRESSURE.

*

70. IN THE IMMEDIATE FUTURE, THERE IS UNLIKELY TO BE ANY CHANGE IN THE ROLE PLAYED SO FAR BY THE SOVIET UNION. MOSCOW

SECRET

PAGE 04 NATO 00412 03 OF 03 252025Z

WILL IMPORT A FEW MILLION TONS OF OIL FROM THE ARAB COUNTRIES (IRAQ, SYRIA, EGYPT, ALGERIA), THUS ENABLING THEM TO REPLAY THE DEBTS ARISING FROM THE CREDITS EXTENDED TO THEM.

71. THE OTHER COMECON COUNTRIES, WITH THE EXCEPTION OF RUMANIA, RELY TO A LARGE EXTENT ON THE SOVIET UNION FOR THEIR OIL. OVER THE LAST FEW YEARS, HOWEVER, ALL THE EAST EUROPEAN COUNTRIES HAVE TAKEN STEPS TO OBTAIN AN INCREASINGLY HIGH PROPORTION OF THEIR OIL SUPPLIES FROM THE MIDDLE EAST (6.6 MILLION TONS IN 1970, OR 16 PER CENT OF IMPORTS AND 11 MILLION TONS IN 1972, OR 22 PER CENT OF IMPORTS).

72. THE RECENT BOOST IN MIDDLE EAST OIL PRICES AND THE NEED TO PAY IN CONVERTIBLE CURRENCY MAY INCREASE THE DEPENDENCE OF THE OTHER COMECON COUNTRIES ON THE S

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